WRITTEN TESTIMONY

of

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Good afternoon. On behalf of CTIA-The Wireless Association®, I want to thank the House Rural Caucus for focusing its attention on the important and timely issue of universal service reform. CTIA is grateful for the opportunity to present its views in this important area on behalf of the more than 200 million wireless consumers. As a significant net payer in to the universal service system, the wireless industry is uniquely positioned to comment on proposals to reform the universal service system. Wireless carriers collectively are responsible for approximately 34% of contributions to universal service, while receiving only approximately 12% of payments. Wireless carriers have strong incentives to ensure that the universal service fund is no larger than necessary, while ensuring that support is available to committed eligible telecommunications carriers (ETCs) on a non-discriminatory basis. In general, CTIA supports reforms that will ensure both incumbents and competitors receive no more support than is necessary to achieve the goals of universal service.

Lessons Learned from the Wireless Industry Experience.

As Congress considers the important question of how to reform the universal service system, we believe there are important lessons that can be learned from the incredible growth of the mobile wireless industry over the last decade. In December

1995, there were 34 million mobile wireless subscribers in the United States. As of December 2005, there were over 200 million mobile wireless subscribers, as compared to approximately 178 million wireline switched access lines. Mobile wireless customers are in both rural and non-rural areas. According to the Bureau of Labor Statistics, the household wireless penetration rate in urban areas is 53.9%. The wireless household penetration rate in rural areas is not far behind – at 50.5%. The FCC has found that 97% of wireless customers live in counties with a choice of three or more wireless carriers and 87% of wireless customers live in counties with a choice of five or more wireless carriers.

Wireless carriers have been so successful, in part, because they have operated in an environment of regulatory constraint that rewards efficiency and innovation. The result has been lower monthly bills, cheaper minutes, and new and innovative service offerings. The average cost of wireless services has declined over time – even as wireless service offerings have expanded. In June 2002, before the Omnibus Budget Reconciliation Act of 1993, the average wireless bill as $68.51 per month. As of June 2005, the average wireless bill was less than $50 per month. In fact, in 1992 dollars, the average wireless bill in 2005 was equal to $35.57 - almost half the earlier bill. For many customers, nationwide bucket of minute plans have made wireless the service of choice for making long-distance calls. In 1995, the average wireless customer had about 115 minutes of use per month. In 2005, the average wireless customer had almost 700 minutes of use per month. In 1995, there were 37 billion minutes of use on wireless networks. In 2004, the wireless industry crossed the one trillion minutes of use threshold. Now, wireless carriers are in the midst of rolling out mobile broadband services.

In spite of this impressive track record, significant challenges remain – particularly with regard to the delivery of services to customers located in high-cost, rural areas. Deployment of wireless services in rural markets is more costly on a per-customer basis than serving a more densely populated area. As with wireline networks, factors such as lower population densities, topography, and geographic isolation make the average cost of providing mobile wireless services in rural areas significantly higher than in urban areas. Those factors, coupled with universal service and intercarrier compensation rules that stack the deck in favor incumbent wireline carriers, create substantial challenges. Universal service can and does play a critical role in improving access to wireless services in high-cost, rural areas. Wireless deployment in some rural areas has occurred because of wireless carrier access to universal service support. The statute and the FCC's rules require ETCs to use support to improve services in high-cost, rural areas.

Wireless ETCs have responded. In many cases, wireless ETCs have used universal service dollars to bring service to rural and insular areas. For example, Cellular South serves 380,000 square miles of rural territory in Mississippi and is using high-cost support to significantly expand its network capacity. Centennial Wireless has brought mobile wireless services to communities, such as Shaw and Blackhawk, Louisiana, that previously had no telephone service at all, wireline or wireless. On the Pine Ridge Indian Reservation in South Dakota, Alltel has used universal service to increase telephone penetration rates from 27% to 92% in only five years. These are areas where the incumbent carrier – the "carrier of last resort" – was unwilling or unable to serve all customers. There are numerous other examples.

Congress Must Resist the Temptation to Reform Universal Service by Discriminating Against Competitors.

As Congress considers reforms to the universal service system, wireless services must be part of the equation. The 200 million wireless consumers – and those consumers yet to receive wireless services – demand as much. Consumers, the only intended beneficiaries of universal service, must be the central focus of any universal service reform efforts. So what do consumers want? If subscribership is any indication, there can be little doubt that consumers want access to mobile wireless services.

As a significant contributor to universal service, the wireless industry shares Congress's concerns about growth in the size of the universal service fund, but any universal service reform that discriminates against wireless carriers will disserve consumers and must be rejected. CTIA has supported proposals to ensure that universal service support is used only for its intended purposes. CTIA supports stringent guidelines adopted by the FCC requiring both incumbent and competitive ETCs to use high-cost universal service support to provide supported services to requesting customers throughout a designated service area (in essence, a "carrier of last resort" obligation).

However, CTIA strongly opposes any anti-competitive proposals to discriminate against wireless carriers in the name of accountability. For example, CTIA opposes proposals to require competitive ETCs to serve an entire incumbent LEC service area in order to receive universal service support. Wireless licensed service areas often do not match incumbent LEC service areas. Wireless licensed service areas are determined by the FCC, not wireless carriers. Denying wireless carriers designations under such a scenario would in some cases prevent wireless carriers from bringing wireless service to remote underserved areas. Moreover, under the FCC's "disaggregation" rules, the

incumbent LEC is in complete control over whether a wireless carrier can receive support when serving low-cost areas. So, this is really a solution without a problem and will only harm rural consumers.

In addition, CTIA opposes proposals to require wireless carriers to become like wireline carriers to receive high-cost universal service funding – something that contradicts the expectations of consumers. Wireless ETCs should not be required to offer local usage and other wireline service packages that are comparable to that offered by the relevant incumbent carrier. CTIA believes that consumers, not regulators, should decide whether they would rather pay one amount for unlimited local usage in a small incumbent LEC local calling area, or a different amount for a certain number of minutes in a much larger (perhaps even national) wireless local calling area. There is no rational basis to determine whether two plans are "comparable" other than consumer choice. CTIA does not believe it is appropriate for government to second guess consumers.

CTIA is particularly troubled by proposals to calculate competitive ETC support based on companies' embedded or "actual" costs. Such proposals threaten the efficiency and innovation that has been a hallmark of the wireless industry's incredible success over the last decade. The embedded cost system has produced increasing demand for subsidies by incumbent LECs. This trend – reflecting incentives for inefficiency inherent in any "actual" cost system – should not be replicated for competitive carriers. Neither the incumbent nor the competitor should receive high-cost support based on their "actual" costs. Rather, as discussed below, both incumbents and competitors should receive support based on the costs of the most efficient technology for a given geographic area.

In addition, the incumbent and competitors should not receive unequal high-cost universal service support. Unequal support will distort markets by creating artificial incentives for consumers to purchase certain services and dissuading market entry by more efficient and innovative competitive alternatives. Importantly, giving less per-line support to one set of competitors puts policy-makers, not consumers, in the position of deciding which provider wins and loses in the competitive marketplace. Consumers lose out when policy-makers second guess the competitive market.

The High-Cost Universal Service Mechanisms Are Ripe for Reform.

If you do not address universal service fund growth by discriminating against competitors, what should be done? The best way to answer that question is to first look at all that is wrong with the current high-cost universal service mechanisms – which represent an increasing majority of the overall universal service fund. There are numerous problems with the high-cost mechanisms, such as: (1) incentives for inefficiency; (2) enrichment of incumbent LEC profits; and (3) impenetrable administrative complexity. Taken together, these problems result in a bloated fund that does not effectively target the appropriate levels of support to different high-cost areas. As a result, the high-cost support mechanisms do a poor job of ensuring that all Americans have access to high-quality, affordable telecommunications and information services. Moreover, the high-cost support mechanisms undermine the efficient development of competition as envisioned by the Act.

Incentives for Inefficiency. Embedded cost-based high-cost universal service mechanisms reward inefficiency by creating incentives and opportunities for carriers to engineer higher embedded costs to receive more support. Despite industry-wide

efficiency gains, advances in technology, and amortization of depreciated equipment, high-cost universal service subsidies continue to increase rather than decrease over time. To debunk one frequently repeated myth, it is new support for incumbents, not competitors, that has been the primary cause of fund growth. From 2000 to 2004, 91.5% of new high-cost universal service support went to incumbent LECs. Since competitive ETCs receive high-cost support based on the incumbent carrier's costs, increased incumbent LEC costs mean more support for both incumbents and competitors.

In practice, the FCC's high-cost support mechanisms compound incentives for inefficiency inherent in embedded cost support mechanisms. For example, the high-cost support mechanisms discourage carriers from taking advantage of economies of scale normally associated with combining operations. Under the high-cost mechanisms, smaller rural incumbent LECs are eligible for more support than larger carriers. Incumbent LECs that increase their customer base risk reducing or eliminating their qualification for high-cost support. The embedded high-cost mechanisms' preference for small carriers also creates incentives for carriers to appear small when, in fact, they are much larger. Incumbent LECs do this by operating numerous "study areas" in a given state or by balkanizing their operations among the various states. One incumbent LEC, for example, operates in 18 study areas in Wisconsin.

Guaranteeing Universal Service Profits. In addition to reimbursing incumbent LECs for their service-related costs, the high-cost universal service mechanisms also are designed to guarantee a prescribed level of profits for incumbent LECs. For example, the federal high-cost support mechanisms for rural and rate-of-return incumbent LECs include a guaranteed rate of return of 11.25%. This rate-of-return is based on the cost of

capital for Regional Bell Operating Companies in 1991. The 11.25% return was based on the RBOCs' 8.8% cost of debt in 1991. We estimate that today rural incumbent LECs have an average cost of debt of only 5.46%. This would allow rural carriers to earn a 15.06% return on equity from the universal service mechanisms. To make matters worse, many incumbent LECs have reported to the FCC that they had profits far in excess of the prescribed rate-of-return. These elevated universal service profits do not translate to improved telecommunications services in high-cost areas. Instead, they simply enrich carriers, while increasing the overall size of the fund to the detriment of other carriers and consumers who end up paying higher universal service pass through charges.

Impenetrable Administrative Complexity. The five separate high-cost support mechanisms, in conjunction with the waivers and other loopholes carriers use to receive additional high cost support, make the system an administrative and enforcement nightmare. Also, support calculations under the various federal high-cost support mechanisms rely on archaic and complicated cost accounting, jurisdictional separations, and reporting rules that have existed in one form or another since 1984.

This administrative complexity makes it exceedingly difficult for the Universal Service Administrative Company ("USAC"), the FCC's independent universal service fund administrator, to audit incumbent LEC cost data submitted for purposes of calculating high-cost support. These wasteful administrative costs are paid by consumers through higher rates for service, as well as higher universal service pass-through charges.

Concluding Thoughts.

While there obviously are many examples of universal service support being used by both incumbents and competitors to improve coverage and quality of service to

consumers, there also clearly is significant waste in the universal service system. If the experience of the wireless industry can by any guide, simplified regulations that encourage and reward efficiency will best benefit consumers by ensuring that universal service is targeted only to where it is most needed and is no more than is necessary. CTIA has long supported market-driven efforts to curb demand for universal service subsidies. Under CTIA's proposals, both incumbents and competitors would receive less support.

At the FCC, CTIA has supported efforts to reduce demand for universal service, while ensuring that support is available to both incumbent and competitive ETCs on a non-discriminatory basis. Specifically, CTIA has proposed combining the current five high-cost universal service mechanisms into one mechanism that calculates support based on the most efficient technology – whether wireline or wireless – in a small geographic area. Although CTIA has suggested that a cost model could be used to calculate support, CTIA is open to other market-driven proposals (such as reverse auctions) that would encourage and reward efficiency. CTIA also has proposed shorter term reforms within the context of the current embedded cost mechanisms that would reduce support for carriers that do not need it and potentially increase support to those carriers with legitimate needs. For example, CTIA has supported: (1) no more subsidization of profits; (2) combining study areas; and (3) transitioning larger rural incumbent LECs to the non-rural high-cost mechanisms. Again, thank you for the opportunity to share the wireless industry's views on universal service reform.